Jury Trial -- right to

Waterman v. Brownstein, Rask, et al., Adv. No. 93-3670-elp

In re Waterman, Case No. 393-31460-hlh13

4/25/95 ELP unpublished

The debtor and his wife sought a jury trial in an adversary proceeding they had filed against a creditor of the estate for rescission, injunctive relief and damages for fraud and negligent misrepresentation. The court applied the three step analysis set forth in Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989). The court determined that there would be a right to a jury trial under the first two steps of the Granfinanciera analysis (the examination of the historical basis of the action and the nature of the remedy sought) because the complaint presents factually intertwined legal and equitable claims.

Under the third step of the Granfinanciera analysis (whether Congress permissibly assigned resolution of the proceeding to a non-Article III tribunal), the court rejected the contention that a party loses the right to a jury trial on all bankruptcy related matters because it files a bankruptcy petition or adversary proceeding. The court determined that the right to a jury trial is determined by whether the dispute involves the claims allowance process or is otherwise integrally related to the restructuring of the debtor-creditor relationship.

Under this test, the debtor had no right to a jury trial because the dispute between him and the defendants involved the same issues that were raised in defense of the defendant's claim against the estate. The court further determined, however, that the dispute between the non-debtor spouse and the defendant did not involve the claim allowance process and was not otherwise integrally related to the restructuring of the debtor-creditor relationship. The non-debtor spouse, therefore, was entitled to a jury trial.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:	)	Case No. 393-31460-hlh13
	)	
DARRELL WALLACE WATERMAN,	)	
	)	
Debtor.	)	
_____	)	
	)	
DARRELL W. WATERMAN and TAUNJI J. WATERMAN, husband and wife,	)	Adversary No. 93-3670-elp
	)	
Plaintiffs,	)	
	)	
v.	)	MEMORANDUM OPINION
	)	
BROWNSTEIN, RASK, SWEENEY, KERR, GRIM & DeSYLVIA, a partnership, and SCOTT L. JENSEN,	)	
	)	
Defendants.	)	

This proceeding is before the court on the defendants' objection to the plaintiffs' request for a jury trial. For the reasons set forth below, I conclude that the plaintiff Taunji Waterman has a right to a jury trial in this proceeding but that

plaintiff Darrell Waterman does not.

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BACKGROUND FACTS

Defendant Brownstein, Rask, Sweeney, Kerr, Grim and DeSylvia ("Brownstein, Rask") provided legal services to plaintiff Darrell Waterman in 1991, 1992 and 1993. To secure payment of past, present and future legal fees, in November of 1992, plaintiffs Darrell and Taunji Waterman, husband and wife (collectively, "the plaintiffs"), executed a deed of trust on their residence in favor of Brownstein, Rask.

Darrell Waterman ("the debtor") filed a Chapter 13 petition on March 15, 1993. Taunji Waterman did not join in the petition. On April 15, 1993, Brownstein, Rask filed a proof of claim in the debtor's bankruptcy case, asserting a secured claim of approximately $84,000. The debtor objected to the proof of claim, asserting that the trust deed was void because it was obtained through duress, in violation of truth in lending laws and in violation of attorneys' ethical standards. Brownstein, Rask requested a hearing on the debtor's objection. Resolution of the objection to Brownstein, Rask's proof of claim has been held in abeyance pending resolution of a motion for relief from the automatic stay filed by Brownstein, Rask and pending resolution of this adversary proceeding.

On November 23, 1993, the plaintiffs filed an adversary

proceeding complaint in the bankruptcy court alleging that Brownstein, Rask violated truth in lending laws in connection with the trust deed and requesting rescission of the trust deed, damages and injunctive relief. Subsequently, the plaintiffs filed an amended complaint renewing their truth in lending act claims and asserting claims for duress, undue influence, fraud, mistake and negligent misrepresentation. In their amended complaint, the plaintiffs sought rescission, injunctive relief, actual damages and punitive damages. The plaintiffs also demanded a jury trial.

Brownstein, Rask objected to the plaintiffs' demand for a jury trial. I took the matter under advisement at a hearing on March 21, 1995.

DISCUSSION

Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989), articulated the standard for determining when there is a constitutional right to a jury trial in a bankruptcy proceeding. In holding that a party who had not filed a claim against the bankruptcy estate had a right to a jury trial in an action by the trustee to recover an allegedly fraudulent transfer of money, the Supreme Court set out a three step test based upon traditional Seventh Amendment law/equity analysis and Article III of the Constitution:

> The form of our analysis is familiar. 'First, we compare the statutory action to 18th-century

> actions brought in the courts of England prior to the merger of the courts of law and equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature.' Tull v. United States, 481 U.S. 412, 417-418, 107 S.Ct. 1831, 1835, 95 L.Ed.2d 365 (1987) (citations omitted). The second stage of this analysis is more important than the first. Id. at 421, 107 S.Ct. at 1837. If, on balance, these two factors indicate that a party is entitled to a jury trial under the Seventh Amendment, we must decide whether Congress may assign and has assigned resolution of the relevant claim to a non-Article III adjudicative body that does not use a jury as a fact finder.

109 S.Ct. at 2790.

The first two steps of the analysis essentially look to whether the proceeding is legal or equitable in nature. In this case, the parties do not dispute that the plaintiffs are entitled to a jury trial under the first two prongs of the Granfinanciera analysis. Plaintiffs' complaint presents both legal and equitable claims. The causes of action for general and punitive damages on the basis of fraud and negligent misrepresentation are legal claims for which there is a right to a jury trial. See generally 9 Charles A. Wright and Arthur R. Miller, Federal Practice & Procedure, Civil 2d §2316 (2d Ed. 1994) (hereafter, "Wright & Miller"). The causes of action seeking injunctive relief and rescission are equitable claims for which there is no right to a jury trial. The factual issues involved in the legal claims overlap and are intertwined with the factual issues involved in the equitable claims. In such circumstances, the

parties' right to a jury trial on the legal claims must be preserved and the legal claims must, therefore, be tried to a jury with the equitable claims being resolved by the court on the basis of the same evidence presented to the jury but in light of the determinations by the jury. Wright & Miller §§ 2302.1 and 2305.

Because there is a right to a jury trial under the first two steps of the Granfinanciera analysis, I now turn to the third step, which examines the effect of the bankruptcy context of the proceeding by looking to whether Congress permissibly assigned the resolution of proceeding to a non-Article III tribunal. In the third step of the analysis, Granfinanciera reasoned that Congress could not deprive parties of their Seventh Amendment right to a jury trial by assigning the matter to the bankruptcy court for determination unless the cause of action involves "public rights". 109 S.Ct. at 2795-96. The Court rejected the view that "public rights" must at a minimum arise between the government and others and explained that the crucial question is whether the right at issue is closely intertwined with a federal regulatory scheme that Congress had the power to enact. 109 S. Ct. at 2797. The Court determined that the fraudulent conveyance action at issue is a private right because it is essentially a suit at common law that more nearly resembles state law contract claims than a creditor's claim to a pro rata share of the

bankruptcy estate. Id. at 2798. The Court also noted that the action is neither integral to the restructuring of the debtor-creditor relation nor does it arise as part of the process of allowance or disallowance of claims, given the fact that the defendant in the action had not filed a proof of claim. Id. at 2799.

Langenkamp v. Culp, 498 U.S. 42, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990), applied the reasoning of Granfinanciera in determining that a creditor who files a proof of claim has no right to a jury trial in a trustee's action against the creditor to recover a preferences. The court reasoned that by filing a claim, the creditor triggers the claims allowance process. 111 S.Ct. at 331. The claim and the ensuing preference action become integral to the structuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction and as such there is no Seventh Amendment right to a jury trial. Id.

Under Granfinanciera and Langenkamp a party may engage in conduct, such as the filing of a proof of claim, that causes the loss of its right to a jury trial. Whether such conduct causes the loss of this right is best analyzed under the third prong of the Granfinanciera analysis. Under that analysis, the question is whether the conduct has the effect of changing the otherwise private right into a public right and bringing the matter within the permissible scope of the bankruptcy court's equity

jurisdiction by triggering the claim allowance process or making the proceeding integral to the restructuring of the debtor-creditor relations.

The primary dispute in this case is whether the debtor's conduct in filing his bankruptcy petition and this adversary proceeding and whether Taunji Waterman's conduct in filing this adversary proceeding caused the loss of their right to a jury trial under such an analysis. Various court have addressed whether conduct by the debtor has caused the loss of a jury trial right under the analysis of Granfinanciera and/or Langenkamp.

In In re Hallahan, 936 F.2d 1496 (7th Cir. 1991), the court held that the debtor had no right to a jury trial in an action to determine the dischargeability of a debt under 11 U.S.C. § 523(a)(6) on two bases: (1) because such a proceeding is an equitable proceeding under the first two parts of the Granfinanciera test; and (2) the debtor cannot assert a right to a jury trial because he voluntarily filed his bankruptcy case. See also In re McLaren, 3 F.3d 958 (6th Cir. 1993). With respect to the second basis, the court reasoned that because creditors subject themselves to equity jurisdiction and lose their jury rights by filing proofs of claim, it is only fair that a debtor subject himself to equity jurisdiction and lose his jury trial rights by filing a bankruptcy petition.

In re Jensen, 946 F.2d 369 (5th Cir. 1991), held that the

debtor was entitled to a jury trial on his state law prepetition claims against a party who had not filed a proof of claim. The court suggested that while both the creditor and the debtor may lose their right to a jury trial if the creditor files a proof of claim, the debtor does not lose all rights to a jury trial simply by filing a petition. 946 F.2d at 373-73. The court reasoned that the only effect of the petition was to pass ownership of the claim to the estate and that it does not convert an otherwise legal dispute into an equitable one unless resolution of the dispute was part of the allowance or disallowance off claims or was integral to the restructuring of the debtor-creditor relationship. Id.

Germain v. Connecticut Nat. Bank, 988 F.2d 1323 (2d Cir. 1993), held that a Chapter 7 trustee had a right to a jury trial in his action against a creditor to recover money damages on the basis of the creditor's postpetition conduct. The court recognized that the filing of a proof of claim or a petition may convert a legal issue to an equitable one and result in the loss of a jury trial right where the issue involves the allowance or disallowance of a claim or is otherwise integrally related to the restructuring of the debtor-creditor relationship. But it found that, even though the creditor had filed a proof of claim, the trustee's action did not involve the claims allowance process because it did not affect the allowance or disallowance of a

claim against the estate. Because the action did not involved the claim allowance process and was not integrally related to any substantive bankruptcy provision or the readjustment of the debtor-creditor relationship, the court concluded that the trustee did not lose his right to a jury trial.

Billing v. Ravin, Greenberg & Zackin, P.A., 22 F.3d 1242 (3rd Cir. 1994), held that Chapter 11 debtors had no right to a jury trial in their action against their bankruptcy counsel for, among other things, malpractice and breach of contract. The court relied on the fact that the debtors raised many of the same claims in both their action against their bankruptcy counsel and in their objection to counsel's request for fees. The court reasoned that this created a close connection between the malpractice action and the objection to fees and made the malpractice allegations part of the claims allowance process, Thus, while the mere filing of a petition did not convert the debtor's claims to equitable ones or result in the loss of jury trial rights, the involvement of the claims allowance process did.

The lesson of these authorities is that a party does not necessarily lose its rights to a jury trial for all bankruptcy related matters by filing a petition or an adversary proceeding or by otherwise engaging in conduct in connection with the bankruptcy case. Rather courts should look to whether the

conduct at issue causes the dispute to become one involving "public rights" under the Granfinanciera analysis. In making this determination, courts should look to the nature of the dispute and the context within which the dispute arises as well as the conduct of the parties in triggering the authority of the bankruptcy court.

If, in light of these factors, the dispute involves the claims allowance process or is otherwise integrally related to the restructuring of the debtor-creditor relationship, it involves public rights and any otherwise existing right to a jury trial is lost by virtue of the connection to the bankruptcy case. This was the express result in Langenkamp and Billing. In addition, this rule can be harmonized with the facts of Hallahan and McLaren because, although those cases contained broad language, in dicta, regarding the loss of a jury trial right caused by the filing of a petition, the disputes involved a determination of the dischargeability of a claim -- a matter that is integrally related to the restructuring of the debtor-creditor relationship. By contrast, in Granfinanciera, Germain and Jensen, cases where the jury trial right was preserved, the courts determined that the dispute did not involve the claims allowance process and was not otherwise integrally related to the restructuring of the debtor-creditor relationship.

Turning to this case, I find that the determination of the

dispute as between the debtor and Brownstein, Rask, and the issues arising in that dispute involve public rights. In his claims in this adversary proceeding, the debtor raises many of the same issues that he raised in his objection to Brownstein, Rask's proof of claim. Under the reasoning of Billing, the debtor's allegations are, in essence, part of the claims allowance process. This converts the issues raised in the debtor's allegations into public rights which are within the scope of the equitable jurisdiction of the bankruptcy court and which may be determined without a jury.

The dispute between Taunji Waterman and Brownstein, Rask, however, stands on a different footing. Although the causes of action raised by Taunji may be factually related to the debtor's causes of action, Taunji's causes of action do not involve the claim allowance process. Nor are the causes of action integrally related to the restructuring of the relationship between the debtor and his creditors. Taunji's causes of action involve private rights under the analysis of Granfinanciera and there is no sufficient connection to the bankruptcy case that converts these causes of action into public rights.

Brownstein, Rask asserts that the fact that Taunji joined as a plaintiff in an adversary proceeding is sufficient to cause the loss of her jury trial rights. I disagree. Brownstein, Rask cites no authority for the proposition that the filing of an

adversary proceeding in bankruptcy court, by itself, causes the loss of jury trial rights. Under the above analysis, I must look to the nature of the causes of action raised by Taunji as well as the fact that she joined in an adversary proceeding complaint. Examining her causes of action in this manner, I find no loss of her right to a jury trial.

CONCLUSION

For the above reasons, I find that there is a right to a jury trial on Taunji Waterman's legal causes of action, but not on any of the debtor's causes of action. Because there is considerable factual overlap between Taunji's and the debtor's causes of action, the causes of action must be tried to a jury which will make all factual findings on Taunji's legal claims. The court will then, in light of the evidence presented to the jury and the determination of the jury, resolve the debtor's claims and the purely equitable rescission claims of Taunji. See Wright & Miller §§ 2302.1 and 2305.

Mr. Case should submit an order consistent with this Memorandum Opinion.

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ELIZABETH L. PERRIS
Bankruptcy Judge

cc: James D. Case
Andrew E. Toth-Fejel Peter R. Mersereau